

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
BRITISH AMERICAN DEVELOPMENT CORP.	:	DETERMINATION
	:	DTA NO. 806635
for Revision of a Determination or for Refund	:	
of Tax on Gains Derived from Certain Real	:	
Property Transfers under Article 31-B of the	:	
Tax Law.	:	

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Petitioner British American Development Corp., 3 Cornell Road, Airport Park, Latham, New York 12110 filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

A hearing was held before Robert F. Mulligan, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on October 23, 1991 at 10:00 A.M., with all briefs to be filed by January 31, 1992. Petitioner appeared by Tobin & Dempf, Esqs. (Kevin A. Luibrand, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

ISSUES

I. Whether petitioner is entitled to an additional \$161,740.00 in original purchase price, based on consideration paid for the purchase of the real property at issue.

II. Whether petitioner is entitled to include, as part of original purchase price, additional interest paid on monies borrowed to create capital improvements.

III. Whether penalties should be abated.

IV. Whether the notice of determination adequately apprised petitioner of the basis for the assessment.

FINDINGS OF FACT

Petitioner, British American Development Corp., is a real estate developer in the Albany, New York area.

In 1980, petitioner began the development of a project on Old Niskayuna Road in the affluent Estates section of Loudonville, New York. The project was initially named "Old Niskayuna", but was later renamed "Cobble Hill".

The site was a portion of approximately 84<sup>1</sup> acres owned by Bernard F. Conners, a principal shareholder of petitioner, individually and together with his wife, Catherine C. Conners, and British American Operations, Ltd., another corporation in which Bernard F. Conners was a principal shareholder. Mr. and Mrs. Conners owned about 65 acres, while British American Operations, Ltd. owned about 19 acres.

By deed dated September 30, 1980, recorded in the Albany County Clerk's Office on January 2, 1981, Bernard F. Conners, individually, Bernard F. Conners and Catherine C. Conners, as husband and wife, and British American Operations, Ltd. conveyed approximately 49 of the 84 acres to petitioner. Approximately 30 acres were conveyed by Mr. and Mrs. Conners and about 19 acres by British American Operations, Ltd. By another deed also dated September 30, 1980 and recorded January 2, 1981, the same

grantors conveyed the balance of the 84 acres to Bernard F. Conners and Catherine C. Conners, husband and wife.

No New York State real estate transfer tax was paid upon the recording of the aforementioned deeds. The consideration recited in each deed was "ONE Dollar (\$1.00) . . . and other good and valuable consideration."

Petitioner calculated a valuation of the land based on the cost of the land to the grantors, i.e., Mr. and Mrs. Conners and British American Operations, Ltd. The cost of the land transferred by British American Operations, Ltd. was \$75,000.00 and the cost of the land transferred by Mr. and Mrs. Conners was \$84,990.00. The total cost of the property to the

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<sup>1</sup>While the schedule included in petitioner's Exhibit "3" shows acreage calculated to three decimal places and appears to balance, it is noted that Lot Number 4 is shown as 2.12 acres but the deed and map show it as 1.12 acres.

grantors, including an appraisal fee of \$1,750.00, was \$161,740.00.

Petitioner's president testified that no payments had actually been made to Mr. and Mrs. Conners or British American Operations, Ltd., but that credits reflecting said amounts had been made on petitioner's books. Petitioner's general ledger account for "Land" shows a debit entry of \$164,490.00 dated May 1980 for "19.22 BAO-30.33 B F Conners".<sup>2</sup>

Cobble Hill was developed in two phases, each phase involving a section mapped around a separate cul-de-sac. The first section was completed in late 1982 or early 1983; the second section was started in the spring of 1983.

Development work consisted of engineering, obtaining the approval of the Town of Colonie, clearing land, constructing and paving roads, putting in sewer, water and storm drainage facilities, as well as other work.

Financing for the development was through a \$1,100,000.00 mortgage loan made by Marine Midland Bank, N.A. The mortgage, dated September 18, 1981 and recorded on said date, was made by petitioner, Bernard F. Conners and Catherine C. Conners. (The mortgage note is not in the record.) Petitioner received the entire proceeds of the loan at one time, rather than as construction expenses were incurred. The same parties entered into a modification and extension agreement with respect to the mortgage loan on April 29, 1983.

Petitioner sold lots at Cobble Hill at various stages of development. It appears that 24 lots were sold between January 6, 1981 and March 2, 1987.

On October 29, 1986, the Division of Taxation ("Division") wrote to petitioner stating that the records of the Albany County Clerk revealed that petitioner had sold several subdivided lots at Cobble Hill with aggregate consideration in excess of \$1,000,000.00. The Division advised petitioner that petitioner had not been properly filing gains tax affidavits. The letter stated, in pertinent part:

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<sup>2</sup>See, Petitioner's Exhibit "4". A footnote on said exhibit indicates the payment to be \$163,390.00. The figures 19.22 and 30.33 apparently refer to the acreage transferred by British American Operations, Ltd. and Mr. and Mrs. Conners, respectively.

"This letter is to inform you that you must file a Gains Tax Questionnaire for each parcel of real property sold to date pursuant to 'Old Niskayuna Lands of British American Development Corp.' subdivision and file a transferors questionnaire for each subsequent transfer at least 20 days before the date of transfer of such subdivided lot. Continued use of the affidavit will be a violation of the express language of the Tax Law."<sup>3</sup>

A reply within 20 days was requested. Petitioner's attorney called the Division requesting additional time to respond to the letter and such request was granted. On January 30, 1987, the Division again wrote to petitioner, stating that the information had still not been received.

After telephone conversations and a meeting on February 18, 1987, petitioner was advised that the subdivision was taxable and a gains tax filing was necessary.

On April 30, 1987, the Division issued a Notice of Determination of Tax Due under Gains Tax Law to petitioner. The notice stated the following:

"On October 29, 1986, we issued a letter advising you that the lot sales in the 'Old Niskayuna Lands Of British American Development Corp.' subdivision required a Gains Tax filing. On January 30, 1987, we issued a follow up letter, again asking you to furnish additional information.

"After various telephone conversations and a meeting with you and your representative on 2/18/87, we advised your representative that in our opinion the sales made pursuant [to] the subdivision were taxable.

"Since you have not filed Gains Tax questionnaires as required by section 1447 of the Tax Law, we have computed your Gains Tax liability using the best information obtainable.

"Gross Consideration	\$2,018,737.00	
Original Purchase Price		-0-
Gain	2,018,737.00	

Exhibit "G-2". The letter also referred to an unrelated transaction which will not be addressed herein.

Tax (on 21 lots)	201,873.70	
Penalty	65,383.80	
Interest	38,335.48	
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Total Tax, Penalty & Interest		305,592.98"

Petitioner filed a petition with the former Tax Appeals Bureau dated May 15, 1987, received by the Tax Appeals Bureau on July 23, 1987, and also submitted a check for \$9,051.20, representing the amount which petitioner calculated as the tax due.<sup>4</sup>

The Bureau of Conciliation and Mediation Services conferee concluded that, based on information provided to the Division, 18 lots had been transferred between July 7, 1983 and March 2, 1987 and that the \$1,000,000.00 gains tax threshold had been reached with the sale of the Cobble Court lot on September 16, 1985.

Total original purchase price for 19 lots was calculated by the conferee at \$1,002,691.27, as set forth in Appendix "A" hereto. The original purchase price per lot was \$52,773.22. Total original purchase price for the 18 units at issue was \$949,917.96.

The conferee disallowed land costs because of lack of supporting documentation, noting that the deed by which petitioner received title reported zero consideration for purposes of computing the real estate transfer tax. The conferee also disallowed \$562,680.00 of the \$684,356.00 in interest expense claimed by petitioner, as it appeared that interest expense had been accrued on loans where only part of the proceeds was used to make the capital improvements to the property. Since petitioner did not show how much interest was accrued on money borrowed to make the capital

improvements, an interest expense of 20% was allowed based on the capital improvements made.

Tax for the 18 lots was recalculated as follows:

<u>Lot</u>	<u>Date of Transfer</u>	<u>Cash Consideration</u>	<u>Broker Fees</u>	<u>Original Purchase Price</u>	<u>Gain</u>	<u>Tax</u>
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<sup>4</sup>See, page 2 of Report of Tax Conference, included with Exhibit "D".

27	7/7/83	\$ 65,000.00	\$ 6,500.00	\$ 52,773.22	\$ 5,726.78	\$ 572.68
17	7/29/83	120,000.00	12,000.00	52,773.22	55,226.78	5,522.68
25	8/1/83	76,000.00	7,600.00	52,773.22	15,626.78	1,562.68
15	11/28/83	110,000.00	11,000.00	52,773.22	46,226.78	4,622.68
21	12/19/83	77,900.00	7,790.00	52,773.22	17,336.78	1,733.68
35	1/1/84	60,000.00	6,000.00	52,773.22	1,226.78	122.68
41	5/31/84	57,500.00	5,750.00	52,773.22	(1,023.22)	-0-
23	12/28/84	80,000.00	8,000.00	52,773.22	19,226.78	1,922.68
33	12/28/84	70,000.00	7,000.00	52,773.22	10,226.78	1,022.68
37	1/31/85	65,000.00	6,500.00	52,773.22	5,726.78	572.68
7	3/25/85	173,000.00	17,300.00	52,773.22	102,926.78	10,292.68
11	5/10/85	115,000.00	11,500.00	52,773.22	50,726.78	5,072.68
Cobble Ct.	9/16/85	180,000.00	18,000.00	52,773.22	109,226.78	10,922.68
5	10/22/85	125,000.00	12,500.00	52,773.22	59,726.78	5,972.68
2	4/17/86	90,000.00	9,000.00	52,773.22	28,226.78	2,822.68
42	6/5/86	90,000.00	9,000.00	52,773.22	28,226.78	2,822.68
3	8/11/86	150,000.00	15,000.00	52,773.22	82,226.78	8,222.68
1	3/2/87	147,000.00	14,700.00	52,773.22	79,526.78	<u>7,952.68</u>
				Total	\$71,736.56	

A Conciliation Order reducing the tax due to \$71,736.56, plus penalty and interest, was issued November 23, 1988.

#### SUMMARY OF THE PARTIES' POSITIONS

Petitioner contends:

(a) that it is entitled to an addition to original purchase price based on the value of the land at the time of the transfer to petitioner, i.e., \$75,000.00 for the 19 acres (approximate) acquired from British American Operations, Ltd. and \$84,990.00 for the 30 acres (approximate) acquired from Mr. and Mrs. Connors, as well as an appraisal fee of \$1,750.00, for a total of \$161,740.00;

(b) that it is entitled to \$418,353.00 in capitalized interest expense;

(c) that penalty should be abated; and

(d) that the notice of determination did not sufficiently apprise petitioner of the basis for the assessment.<sup>5</sup>

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<sup>5</sup>With respect to this issue, petitioner's representative stated at the outset of the hearing:

"And that is a law argument that I would raise in papers following the conclusion of the hearing within whatever time period you allow but, factually, we will not be addressing that issue today." (Tr., p. 11.)

The Division essentially claims that petitioner has not established the original acquisition cost of the land or any interest expense beyond the amount allowed by the Bureau of Conciliation and Mediation Services conferee.

#### CONCLUSIONS OF LAW

A. Tax Law § 1441, which was effective March 28, 1983, imposes a tax of 10% on gains from the sale of real property in New York State.

B. Tax Law § 1440.3 defines the term "gain" as:

"the difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price."

C. The regulations, in 20 NYCRR 590.14, provide, in pertinent part, as follows:

"Question: What is the definition of original purchase price?

"Answer: Generally, the original purchase price of real property is the consideration paid or required to be paid to acquire the real property plus the consideration paid or required to be paid for the construction of any capital improvements made or required to be made to the real property plus certain fees incurred to sell the property."

D. The regulations, in 20 NYCRR 590.15(a), provide, in pertinent part, as follows:

"Question: What amounts are included in the price paid to acquire an interest in real property?

"Answer: The price paid to acquire an interest in real property includes the amount of money, property or any other thing of value provided or given up to acquire the interest in real property including the amount of any mortgage, lien or other encumbrance on the real property which was assumed or taken subject to. For example, if a transferor buys real property for cash and becomes liable for an existing mortgage on the property, his original purchase price includes both the amount of cash and the amount of unpaid mortgage he assumed.

"If a transferor cancelled or discharged any indebtedness of his seller when he acquired the real property, the amount of the indebtedness cancelled or discharged would also be included in his original purchase price.

"If real property is acquired in an exchange for other property, the fair market value of the property given up is included in the original purchase price of the real property acquired."

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It should be noted that petitioner waived closing arguments in lieu of a brief; no brief, however, was submitted.

E. The regulations, in 20 NYCRR 590.16, which treat consideration paid for capital improvements, provide in subdivision (d):

"Question: What additional costs are allowed if incurred during a construction period?

"Answer: Other costs that are clearly associated with construction of a real estate project can also be included as a cost of constructing a capital improvement. If the capital improvement requires a construction period, a period of time in which necessary activities are conducted to bring the improvement on the real property to that state or condition necessary for its intended use, the interest cost paid during that period on a construction loan, real property taxes, insurance or similar items are includable as a cost of construction."

Said subdivision also provides, by way of illustration, that "interest paid during the construction period on loans where the proceeds of such loans were used to make capital improvements to real property" is a type of cost that may be included in determining original purchase price.

F. Interest paid on a loan the proceeds of which were used to acquire real property are not allowable as a cost to acquire property for purposes of original purchase price (20 NYCRR 590.15[c]).

G. Petitioner has not sustained its burden of proof to show that the sum of \$161,740.00 was paid to acquire the land from Bernard F. Connors and Catherine C. Connors and British American Operations, Ltd. The amount claimed, which is based on the original cost of Mr. and Mrs. Connors and British American Operations, Ltd., appears to be reasonable, but there is insufficient evidence to show that petitioner gave consideration to the grantors. Petitioner was unable to explain why it originally claimed the deeds were transferred without consideration and no real estate transfer tax was paid. The debit entry in the general ledger Land account does not prove that consideration was paid to the grantors. Conspicuously absent from the record is proof of promissory notes running to the grantors or even ledger entries showing credits to the grantors.

H. Petitioner has also failed to sustain its burden of proof to show that it is entitled to additional interest paid on funds borrowed for the construction of capital improvements.



Petitioner's schedule of "Capitalized Costs"<sup>6</sup> is patently erroneous with respect to the reconstructed interest calculations. First of all, the schedule allocates interest for land acquisition costs, which interest is not allowable under 20 NYCRR 590.15(c); secondly, it allocates interest to the period prior to the date of the mortgage. The mortgage was dated September 18, 1981, but interest is shown accruing as early as January 1980. There is no evidence in the

record that there was a loan prior to the date of the mortgage. Comparison of the aforementioned schedule with petitioner's cancelled checks<sup>7</sup> for the period at issue seems to confirm the payment of the development costs stated in the schedule; however, because of the foregoing errors it is virtually impossible to determine whether petitioner is entitled to more interest than was allowed by the conferee.<sup>8</sup>

I. Petitioner has not shown that its failure to file a return and pay tax within the time required by statute was due to reasonable cause and not due to willful neglect. Accordingly, the penalty imposed under Tax Law § 1446.2(a) is sustained.

J. While petitioner's representative stated that he would raise the issue of the adequacy of the notice of determination in papers to be filed after the hearing, said issue was not so raised. Accordingly, the notice of determination is deemed to have adequately apprised petitioner of the basis for the assessment.

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<sup>6</sup>Petitioner's Exhibit "9".

<sup>7</sup>Petitioner's Exhibits "10(a)" through "10(f)".

<sup>8</sup>It is noted that the loan proceeds were not payable as the various expenditures were made, but that petitioner received the entire \$1,100,000.00 at the time the loan was made. Presumably, petitioner would have invested the monies until used, in which case the actual net interest expense would have been less than the sums paid. This point was not treated at the hearing and is mentioned only as an observation.

K. The petition of British American Development Corp. is denied and the notice of determination issued April 30, 1987, as reduced by the Conciliation Order dated November 23, 1988, is sustained.

DATED: Troy, New York  
February 18, 1993

/s/ Robert F. Mulligan  
ADMINISTRATIVE LAW JUDGE

# APPENDIX "A"

"Year	1980	1981	1982	1983 1/1/83 to 3/28/83	1983 3/29/83 to 12/31/83
Costs Claimed:					
Capital Improvements	181301.92	106437.73	30381.72	24.00	242860.31
Management Fees	18130.19	10643.77	3038.17	2.40	24286.03
Interest Expense		214395.57	169758.75	30773.90	81035.01
Mortgage Costs	6551.04	26871.00			
Land Costs	161740.00				
Real Estate Taxes				14466.46	
Legal Fees					
Disallowed:					
Land Costs (see Note 1)	<161740.00>				
Interest Exp. (see Note 2)		<193108.02>	<163682.41>	<30769.10>	<32462.95>
Add: Interest Exp. (see Note 2)	36260.38				
Totals	<del>242243.53</del>	<del>165240.05</del>	<del>39496.23</del>	<del>14497.66</del>	<del>315718.40</del>

[Year]	1984	1985	1986
[Costs Claimed:]			
[Capital Improvements]	157164.65	69317.41	2187.42
[Management Fees]	15716.47	6931.74	218.74
[Interest Expense]	93896.03	62497.28	31999.85
[Mortgage Costs]			
[Land Costs]			
[Real Estate Taxes]			26773.68
[Legal Fees]			12206.00
[Disallowed:]			
[Land Costs (see Note 1)]			
[Interest Exp. (see Note 2)]	<62463.10>	<48633.80>	<31562.37>
[Add: Interest Exp. (see Note 2)]			
[Totals]	<del>204314.05</del>	<del>90112.63</del>	<del>41823.32</del>

## APPENDIX "A" (Cont.)

### Allocation of Costs to (6) Exempt Sales

#### Costs By Year

1980	\$242243.53	
1981	165240.05	
1982	39496.23	
1983 (1/1/83-3/28/83)	14497.66	
Total	461477.47	
Cost Per Lot (25 Lots)	\$18459.10	
Costs Allocated to (6) Lots	110754.60	
Cost Carried Forward	350722.87	
1983 (3/29/83 - 12/31/83)		315718.40
1984	204314.05	
1985	90112.63	
1986	41823.32	
Total		<del>1002691.27</del>

Note (1) Land costs were disallowed for lack of supporting documentation. It should be noted that on the deed transferring fee title into the Taxpayer, the amount of consideration reported to compute the Real Estate Transfer Tax was none.

Note (2) The interest expense of \$684,356 being claimed, when compared to the capital improvements made of \$789,675, equals 87%. It appears that the interest expense was accrued on loans where only part of the proceeds were used to make the capital improvements to the real property subject to tax. Since the Taxpayer has not provided information on how much interest was accrued on money borrowed to make the capital improvements, we have allowed an interest expense of 20% based on the capital improvements made."